INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes and regulations involved	2
Statement	2
Argument	4
Conclusion	11
Appendix	12

CITATIONS

Cases:	
Anderson v. *Wilson*, 289 U. S. 20	5
Ayer v. *Commissioner*, 26 B. T. A. 9	7
Bankers' Trust Co. v. *Bowers*, 23 F. (2d) 941	7, 8
Bankers' Trust Co. v. *Bowers*, 295 Fed. 89	5
Barnes, Executor v. *Commissioner*, 8 B. T. A. 360	6
Blodget v. *Commissioner*, 13 B. T. A. 1243	6
Brewster v. *Gage*, 280 U. S. 327	6, 9, 10
Catherwood v. *United States*, 291 Fed. 560	5
Central Trust Co., Executor v. *Commissioner*, 19 B. T. A. 867	6
Eldredge v. *United States*, 31 F. (2d) 924	7
Elmhirst v. *United States*, 69 C. Cls. 295, certiorari denied, 282 U. S. 851	7
Heiner v. *Tindle*, 276 U. S. 582	8
McKinney v. *United States*, 62 C. Cls. 180, certiorari denied, 273 U. S. 716	7, 9
Myers v. *United States*, 72 C. Cls. 214	7
Old Mission Portland Cement Co. v. *Helvering*, decided Dec. 3, 1934, No. 107, Oct. Term, 1934	9
Pierce v. *Commissioner* 22 B. T. A. 1070	7
Straight, Executrix, v. *Commissioner*, 7 B. T. A 177	6
Wolfe, Executor v. *Commissioner* 15 B. T. A. 835	6
Statutes:	
Revenue Act of 1921, c. 136, Sec. 202 (a) (2), 42 Stat. 227, 229	8
Revenue Act of 1924, c. 234, 43 Stat. 253:	
Sec. 2 (U. S. C., Title 26, Sec. 1262)	5
Sec. 204 (U. S. C., Title 26, Sec. 935)	12
Sec. 212 (U. S. C., Title 26, Sec. 953)	13
Sec. 219 (U. S. C., Title 26, Sec. 960)	13

Statutes—Continued. Page

Revenue Act of 1926, c. 27, 44 Stat. 9:
Sec. 2 (U. S. C. App., Title 26, Sec. 1262) 5
Sec. 204 (U. S. C. App., Title 26, Sec. 935) 14
Sec. 212 (U. S. C. App., Title 26, Sec. 953) 14
Sec. 219 (U. S. C. App., Title 26, Sec. 960) 14
Revenue Act of 1928, c. 852, 45 Stat. 791, 818, 879:
Sec. 113 14
Sec. 702 15
Miscellaneous:
Treasury Decision 4011, VI-1 Cum. Bull., p. 77 9
Treasury Regulations 45, Art. 343 5
Treasury Regulations 62, Art. 343 5
Treasury Regulations 65, Art. 343 16
Treasury Regulations 69, Art. 343 16
Treasury Regulations 74, Arts. 596, 863 17

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 602

CAVOUR HARTLEY, EXECUTOR OF THE ESTATE OF G. G. Hartley, petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the United States Board of Tax Appeals (R. 18–27) are reported in 27 B. T. A. 952. The opinion of the Circuit Court of Appeals (R. 113–122) is reported in 72 F. (2d) 352.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 9, 1934. (R. 123). A petition for rehearing was filed August 2, 1934 (R. 124–128), and was denied October 17, 1934 (R. 128). The petition for a writ of certiorari was filed on December 27, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the basis for determining gain or loss on the sale of properties held by the executor of an estate, and for computing depreciation and depletion on such properties, is the value of the properties at the date of the decedent's death or the cost thereof to the decedent.[1]

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 12–17.

STATEMENT

The petitioner is executor of the estate of G. G. Hartley, who died January 11, 1922, leaving real, personal, and mixed properties valued at approximately $3,000,000 and producing about $200,000 gross income annually. Among the properties were

[1] Three other questions involving the allowability of certain expense and loss deductions claimed were presented below, but these are not in issue here.

about fifteen iron mines operated under royalty leases and several thousand pieces of real estate consisting of farms and improved rental property. The personal property consisted of a quantity of miscellaneous investment and income securities (stocks, government and corporate bonds, notes and accounts receivable). (R. 19, 85–97.)

The petitioner duly filed his income-tax returns as executor for 1924 and 1925. In the 1924 return he reported a loss of $1,184.39, and on the 1925 return a gain of $255.05, from the sale of capital assets. Deductions were claimed for depletion of iron mines in the amount of $41,663.62 for 1924 and $67,272.81 for 1925. Deductions also were claimed in each year for depreciation of rental property in amounts not in controversy. The gain or loss on the sale of capital assets and the deductions for depletion and depreciation, as reported on the returns, were computed upon the basis of the values of the several properties at the date of the decedent's death. Upon audit of the returns the Commissioner made numerous adjustments of profits from sales and of depletion and depreciation and determined deficiencies. On July 27, 1928, the petitioner filed with the Commissioner a written election not to have the income-tax returns of the estate governed by the provisions of Section 702 (a) of the Revenue Act of 1928 (*infra*, p. 15). (R. 20.)

Before the Board of Tax Appeals the petitioner contended that the correct basis for computing the

gain or loss on sales of property, and the deductions for depletion and depreciation, was the basis which the properties had in the hands of the decedent, namely, the cost or March 1, 1913, value thereof (R. 21). The Commissioner, on the other hand, contended that the basis used in the returns (value at the date of the decedent's death) was correct. The Board of Tax Appeals sustained the Commissioner, and the court below affirmed.

ARGUMENT

The Revenue Acts of 1924 and 1926 provide that the basis for determining gain or loss on the sale of property *acquired* after February 28, 1913, shall be the cost thereof, and that in the case of property acquired before March 1, 1913, the basis shall be the cost or the value thereof on that date, whichever is greater. Section 204 (a) and (b), *infra*, pp. 12, 14. While the statutes do not specifically prescribe the basis for property of the estates of deceased persons, the regulations adopted by the Treasury Department for the proper administration of the Acts provide that the gain or loss on the sale of property by the executor of an estate shall be determined upon the basis of the value of the property at the date of the decedent's death. Article 343, Regulations 65 and 69, *infra*, pp. 16, 17. The returns filed here followed these regulations. Similar provisions were incorporated in the regulations under the Revenue Acts of 1918 and 1921 which,

like the statutes here involved, did not expressly prescribe the basis for property of decedents' estates. Article 343, Regulations 45 and 62.

We submit that the regulations correctly interpret the statutes here involved. A decedent's estate for income-tax purposes is a separate taxable entity, entirely distinct from the decedent, the tax being assessed to and paid by the executor or administrator. *Bankers' Trust Co.* v. *Bowers,* 295 Fed. 89 (C. C. A. 2d); *Catherwood* v. *United States,* 291 Fed. 560 (C. C. A. 3d); Section 2 (a) (1) (9), Revenue Acts of 1924 and 1926. See also *Anderson* v. *Wilson,* 289 U. S. 20, 27. The net income of the estate is taxable just as the net income of an individual is taxable, and is to be computed in the same manner as that of an individual. The property of a decedent immediately upon death passes to his estate. During the period of administration or settlement the estate is the entity, the taxpayer, which receives the income and is taxable thereon. The estate as an entity *acquires* the property upon the death of the decedent.

In prescribing cost as the basis of property acquired after February 28, 1913, the statutes obviously mean the cost of the property to the *taxpayer* who sells the same and whose income is to be determined. It is not to be presumed that the statutes contemplate the determination of the gain or loss on a sale of property by one taxpayer,

which is to be included in the computation of his taxable net income, upon the basis of the cost of such property to another and distinct taxpayer.

In the case of property acquired by devise, bequest, or inheritance the basis prescribed is the fair market value at the time of acquisition (Section 204 (a) (5), *infra*, p. 12), which it has been held is the date of the decedent's death and not the date of distribution to the devisee, legatee, or heir. *Brewster* v. *Gage*, 280 U. S. 327. In so holding, this Court took cognizance of the rule applied by the regulations to sales by the executor of a decedent's estate and said (pp. 335–336):

> The Revenue Act of 1918 and subsequent Acts taxed incomes of estates during the period of the administration including profits on sales of property, and such gains are calculated on value at date of decedent's death. There appears to be no reason why gains or losses to the estate should be calculated on one basis and those to the residuary legatees on another.

The Board of Tax Appeals has consistently held that the basis for determining the gain or loss on the sale of property by the estate of a decedent is the value of such property at the date of death of the decedent. *Straight, Executrix* v. *Commissioner*, 7 B. T. A. 177; *Barnes, Executor* v. *Commissioner*, 8 B. T. A. 360; *Blodget* v. *Commissioner*, 13 B. T. A. 1243; *Wolfe, Executor* v. *Commissioner*, 15 B. T. A. 835; *Central Trust Co., Executor* v.

Commissioner, 19 B. T. A. 867; *Pierce* v. *Commissioner,* 22 B. T. A. 1070; *Ayer* v. *Commissioner,* 26 B. T. A. 9.

The District Court for the Southern District of New York, in a well reasoned opinion, has taken the same view and, construing the provisions of the Revenue Act of 1926, here involved, held that the basis for determining the gain or loss on the sale of property by the executor of a decedent's estate is the value of the property at the date of decedent's death. *Bankers' Trust Co.* v. *Bowers,* 23 F. (2d) 941. The Circuit Court of Appeals for the Sixth Circuit has held likewise. *Eldredge* v. *United States,* 31 F. (2d) 924, 930.

The Court of Claims alone has taken the contrary view. *McKinney* v. *United States,* 62 C. Cls. 180, certiorari denied, 273 U. S. 716; *Elmhirst* v. *United States,* 69 C. Cls. 295, certiorari denied, 282 U. S. 851; *Myers* v. *United States,* 72 C. Cls. 214. The last two cases were decided on the authority of the first.[2] The basis of the decision in the *McKinney* case, which involved the Revenue Act of 1918, was that since the statute fixed cost as the basis of the property and there is no cost to the executor of a decedent's estate, who is the personal representative of the decedent, the cost

[2] In the *Myers* case, *supra,* two out of the five judges sitting concurred in the result solely on the ground that the same question had been decided by the court in two earlier cases, one of the two stating in a carefully reasoned opinion his personal disagreement with the views of the majority.

to the decedent must be used as the basis, the court saying (p. 188):

> The stock was the same stock as it had been in the hands of the decedent; and, as stated, had he lived and sold the stock himself there would have been no question of taxable gain. The fact that they were executors did not alter the situation.

The view taken by the Court of Claims, we submit, is unsound and cannot be supported. The court placed undue emphasis upon the word "cost" used in the statute and the representative capacity in which an executor acts, and failed to give proper effect to related provisions of the statute. This Court has held that the provision of the statute making cost or March 1, 1913, value the basis does not exclude the use of market value when there was literally no cost to the taxpayer at the date as of which basis is taken. *Heiner* v. *Tindle,* 276 U. S. 582, 585–586. When Congress intended that cost to some one other than the taxpayer should be the basis, as in the case of property acquired by gift, it expressly so provided. See Section 202 (a) (2) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 229. Moreover, as was pointed out in the opinion in *Bankers' Trust Co.* v. *Bowers,* 23 F. (2d) 941, *supra,* 943, the rule that market value at the time of acquisition shall be the basis in the case of property acquired by bequest, devise, or inheritance furnishes a guide to the intent of Congress in respect of the present question, for there

is no logical reason for distinguishing between property in the hands of an executor and property in the hands of a legatee or heir. See also *Brewster* v. *Gage,* 280 U. S. 327, 335–336, *supra.* Manifestly, the rule advocated by the Commissioner will not always work a hardship upon the estate, as the petitioner suggests. (Br. 18.) For although in some instances it will increase the tax, in others it will make it less. See *Bankers' Trust Co.* v. *Bowers, supra.*

Except for the brief period from April 6, 1927, to July 7, 1928, during which an amendment to the regulations recognized cost to the decedent as the basis (T. D. 4011, VI–1 Cumulative Bulletin, p. 77), the regulations of the Treasury Department uniformly have provided that value at the date of the decedent's death is the proper basis for property of the estate, and it is to be noted that the amendment referred to was prompted solely by the decision in the *McKinney* case, *supra.* The consistent departmental interpretation of the statutes and uniform practice of the Department for many years before the temporary change prompted by the decision of the Court of Claims is entitled to great weight, and the repeated reenactment of the pertinent provisions in successive Revenue Acts gives to the regulations "the force of law." *Old Mission Portland Cement Co.* v. *Helvering,* decided December 3, 1934, No. 107. It should also be noted that the Revenue Act of 1928, Section 113 (a) (5) (*infra,* p. 14),

the first statute to prescribe in specific terms the basis for property of a decedent's estate, provides that the basis shall be the value at the date of decedent's death. Section 702 (a) of the Revenue Act of 1928 (*infra*, p. 15), which authorized the closing of returns for earlier years if filed on the basis of regulations then in force or on the basis of value at the date of decedent's death, is not applicable here, for the taxpayer elected in writing not to have those provisions applied and in such cases Section 702 (b) provided that the gain or loss of the estate should be computed in accordance with the law properly applicable without regard to that section.

We think that the decision of this Court in *Brewster* v. *Gage, supra,* established that the basis for gain or loss on the sale of property by a decedent's estate is the value of the property at the date of decedent's death. The decisions of the Board of Tax Appeals and the courts, except the Court of Claims, are in accord. The departmental regulations so provide. The Revenue Act of 1928 expressly provides such basis, so that the question cannot arise for any year subsequent to 1927.

Under the statutes the basis for computing depreciation and depletion on property is the same as the basis for determining the gain or loss on the sale of property. Section 204 (c), Revenue Acts of 1924 and 1926, *infra*, pp. 13, 14. Since the correct basis for determining gain or loss on the sale of

property of a decedent's estate is the value thereof at the date of the decedent's death, it follows that the basis for computing depreciation and depletion on the property of the estate is the value of the property at the date of decedent's death.

CONCLUSION

The decision below is correct and is in accord with the decisions of this Court, the Board of Tax Appeals, and all other courts which have had occasion to pass upon the question, except the Court of Claims. The question presented is one solely of construction of statutes prior to the Revenue Act of 1928 and is definitely set at rest by the latter statute. It is not thought that the question is of sufficient importance to warrant review by this Court. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1935.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1924, c. 234, 43 Stat. 253:

> SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—
>
> * * * * *
>
> (5) If the property was acquired by bequest, devise, or inheritance, the basis shall be the fair market value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in subdivision (c) or (e) of section 402 of the Revenue Act of 1921, or in subdivision (c), (d), or (f) of section 302 of this Act;
>
> * * * * *
>
> (b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property (or, in the case of such property as is described in paragraph (1), (4), or (5), of subdivision (a), the basis as therein provided), or (B) the fair market value of such property as of March 1, 1913, whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due re-

gard shall be given to the fair market value of the assets of the corporation as of that date.

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, * * * (U. S. C., Title 26, Sec. 935).

SEC. 212. (a) In the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * * (U. S. C., Title 26, Sec. 953).

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

* * * * *

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

* * * * *

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

* * * * *

(U. S. C., Title 26, Sec. 960).

Sections 204 (a) (5), (b), and (c), and 212 (a), (b), and 219 (a) (3) and (b), of the Revenue Act of 1926, c. 27, 44 Stat. 9 (U. S. C. App., Title 26, Secs. 935, 953, and 960), so far as material, are identical with the corresponding provisions of the Revenue Act of 1924, set forth above.

Revenue Act of 1928, c. 852, 45 Stat. 791, 818, 879:

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(5) *Property transmitted at death.*—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall

be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death;

* * * * *

SEC. 702. BASIS OF PROPERTY UPON SALE BY ESTATE—RETROACTIVE.

(a) If in the return of any decedent's estate for any taxable year preceding the taxable year 1928, the basis, upon which gain or loss realized upon the sale or other disposition of property acquired by the estate from the decedent was computed, was the value of the property at the time of the death of the decedent or was in accordance with the regulations in force at the time such return was filed, then the computation of such gain or loss shall be made upon such basis, unless claim for refund or credit in respect of such basis, or a written election not to come within the provisions of this subsection, has been filed by the estate before the expiration of the period of limitation for filing claims.

(b) In every other case the computation of the gain or loss realized by an estate in any taxable year preceding the taxable year 1928 from the sale or other disposition by it of property acquired by the estate from the decedent, shall be made on such basis as is

in accordance with the law properly applicable thereto, without regard to any provision of this Act.

Treasury Regulations 65, promulgated under the Revenue Act of 1924:

> ART. 343. *Decedent's estate during administration.*—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its value at the death of the decedent, the excess is income, or may be capital gain, taxable to the estate. See article 1594. * * *

Article 343 of Treasury Regulations 69, so far as material, is substantially identical with Article 343 of Regulations 65, set forth above.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

> ART. 596. *Property transmitted at death.*—In the following cases the basis for determining gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the fair market value of the property at the time of the death of the decedent:
>
> * * * * *
>
> (3) Property, whether real or personal, in the hands of a decedent's estate, acquired by the estate from the decedent (see article 863).
>
> * * * * *

Article 863 of Regulations 74 is substantially identical with Article 343 of Regulations 65 and 69, *supra*.

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